

## **The Impact of Repealing the Retirement Earnings Test on Rates of Poverty**

This paper summarizes an analysis of the implications of potential changes in filing behavior that might result from changes in the retirement earnings test (RET). In general, the earlier one files for Social Security benefits the lower his or her monthly benefit. Elimination of the RET might lead to some individuals filing for Social Security benefits at an earlier age than they otherwise might, and thus could lead to reductions in individual incomes and increases in the number of people in poverty. Using matched 1994 Current Population Survey and Social Security Administration administrative data, this analysis examines the potential changes in individual income and the number of people in poverty that could have resulted for beneficiaries in 1993 from earlier elimination of the RET at either the normal retirement age (NRA), which is currently age 65, or at age 62.

In general, we find that even if individuals accelerate their filing for Social Security benefits as a result of elimination of the RET at age 65, there would be little or no change in the number of people below the poverty line. However, if the RET were eliminated at age 62 and individuals accelerate their filing for Social Security benefits, the number of people below the poverty line would increase. This analysis provides a range of estimates for the impact of eliminating the RET on rates of poverty, which illustrates the implications of potential changes in the RET.

Specifically, this paper:

- Explains how the RET works, focusing on the differences between the test for beneficiaries at the NRA and above and for beneficiaries aged 62 through NRA;
- Describes the approach used to estimate the poverty effects of repealing the RET;
- Provides poverty estimates for repealing the RET at NRA and the RET at 62; and
- Provides detailed demographic profiles on the population likely to get moved into poverty if the RET at 62 were eliminated.

### **HOW THE RETIREMENT EARNINGS TEST (RET) WORKS**

The Social Security Act of 1935 specified that beneficiaries would lose all their benefits if they had any earnings. Over the years, however, Congress has eased the RET's restrictions (allowing beneficiaries to supplement their benefits with earnings) by increasing the amount of exempted earnings, reducing the age of exempted beneficiaries, and liberalizing the formulas for reducing benefits.

The RET affects the timing of a person's benefits but has little effect on total benefits received over a lifetime. The details differ depending on whether a beneficiary is above or below the NRA (It does not apply to beneficiaries aged 70 and above). In both cases, however, the earlier a person begins to draw benefits, the smaller his or her monthly benefit will be.

## Retirement Earnings Test at the Normal Retirement Age

Under current law, beneficiaries aged 65 through 69 in 2000 have \$1 in benefits withheld for every \$3 earned above \$17,000. This threshold will increase in stages to \$30,000 in 2002 and increase automatically thereafter with the average wage in the U.S. economy.

Delayed retirement credits (DRCs) are provided to compensate workers at the NRA through age 69 whose benefits are withheld under the RET. The DRC increases the worker's retirement benefit for each month that benefits are fully withheld after the NRA. The DRC is 6 percent per year for workers age 65 in 2000, and it will increase 0.5 percentage points every two years until it reaches 8 percent per year for workers reaching age 65 in 2008 and later. At that time, benefits lost due to the RET and/or delayed retirement generally will be offset in an actuarially fair manner by the increase in benefits resulting from DRCs. (See example 1.)

### Example 1 How the Retirement Earnings Test Affects Beneficiaries at the Normal Retirement Age and Above

In 2000, a worker files for benefits at age 65 (the normal retirement age) and receives his/her full benefit of \$1,000 per month. If this worker had delayed filing for benefits for one additional year, his/her benefit would have been increased by 6 percent to \$1,060 per month. This increase reflects the fact that he/she had not received benefits for one full year for which he/she was entitled. This "delayed retirement credit" amounts to 6 percent of the full annual benefit amount each year in 2001 and later.

If this beneficiary files for benefits at age 65 and continues to work, he/she may be affected by the RET as follows:

- Scenario 1: His/her earnings never exceed the RET earnings threshold, so the RET has no effect on his/her benefit and he/she continues to receive his/her full benefit amount of \$1,000 per month for the rest of his/her life.
- Scenario 2: His/her earnings exceed the RET earnings threshold to the extent that all his/her benefits at age 65 are withheld. As a result, he/she receives a delayed retirement credit of 6 percent, which increases his/her benefit to \$1,060 per month, accounting for the fact that he/she received no benefits at age 65 due to the RET.

These scenarios represent the extreme cases. If the worker receives partial benefits, then the delayed retirement credit adjusts his/her benefit accordingly. Also, a worker could have earnings after age 65, which could increase his/her full benefit. Annual cost-of-living adjustments would also raise his/her benefit.

## Retirement Earnings Test at Age 62

In 2000, beneficiaries between age 62 and the NRA have \$1 in benefits withheld for every \$2 earned above \$10,080. (This amount is adjusted annually to reflect the growth in the average wage in the U.S. economy.) Beneficiaries also have their benefits actuarially reduced for each month that they receive benefits before the NRA. For example, a person born in 1938, who starts to collect benefits at age 62, receives 79.2 percent of what he or she would have received at age 65 and 2 months (his or her NRA). If benefits are withheld before the NRA because of the RET, the actuarial reduction is adjusted at the NRA to exclude those months, so there would be no permanent reduction for those months. (See example 2.)

### Example 2 How the Retirement Earnings Test Affects Beneficiaries Age 62 through the Normal Retirement Age

In 2000, a worker files for Social Security retirement benefits at age 62 rather than waiting until age 65 and 2 months (his/her normal retirement age). Had he/she waited to file until age 65 and 2 months, his/her full benefit amount would have been \$1,000 per month. Because he/she chose early retirement benefits at age 62, his/her benefits are reduced by 20.8 percent to \$792 per month.

This reduction accounts for the fact that this beneficiary will receive benefits for 38 additional months. However, over his/her lifetime, he/she is expected to receive the same total amount of benefits (based on actuarial projections of life expectancy and adjustments for interest).

If this beneficiary continues to work after filing for benefits at age 62, he/she may be affected by the RET as follows:

- Scenario 1: His/her earnings never exceed the RET earnings threshold, so the RET has no effect on his/her benefits, and he/she continues to receive 79.2 percent of his/her full monthly benefit amount for the rest of his/her life—\$792.
- Scenario 2: His/her earnings exceed the RET earnings threshold to the extent that his/her benefits are partially or fully withheld in every month before reaching his/her NRA. As a result, his/her benefits are recomputed at age 65 and 2 months as 100 percent of his/her full benefit amount of \$1,000 per month, accounting for the fact that he/she never received full benefits earlier due to the RET.

These scenarios represent the extreme cases. If the worker receives partial benefits before he/she reaches age 65, then the adjustment to his/her benefit at age 65 will reflect that benefit payment in an actuarially fair manner. Also, a worker could have earnings after age 62, which could increase his/her full benefit. Annual cost-of-living adjustments would also raise his/her benefit.

## **APPROACH USED TO ESTIMATE POVERTY EFFECTS OF ELIMINATING THE RET**

To analyze the poverty effects of eliminating the RET, data from the March 1994 Current Population Survey—a nationally representative survey—are matched with Social Security Administration administrative records. These data indicate how much each person received in Social Security and other income in 1993.

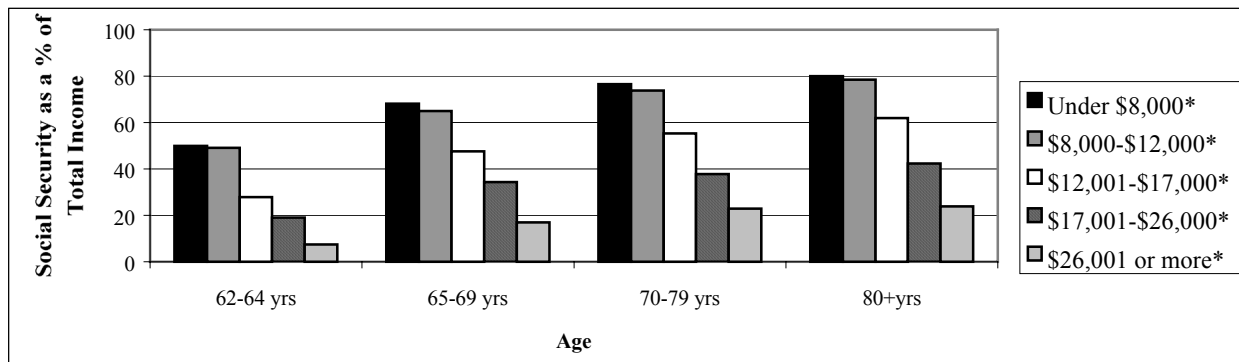
These data are used to determine the Social Security benefit amount the person would have received in 1993 had there never been an RET at 62 and over or an RET at NRA and over. Essentially, this approach calculates the effects of changes in filing behavior on poverty. It is assumed that many people would have claimed benefits earlier had the RET never existed and that, for many, this would mean lower Social Security income (because, for example, benefits claimed before the NRA are permanently reduced). Once the difference in Social Security income is estimated, it is possible to determine whether this would change the person's poverty status and to report how many more people would be in poverty if the RET had never been in effect.

### **Historical Approach**

This is an historical approach, which examines the Social Security population at a point in time in the recent past and asks how Social Security income and poverty status would be different assuming that the RET had never existed. It does not take a cohort of people approaching their retirement years and forecast the poverty effects from repealing the RET at 62 or the RET at NRA.

There are limitations and advantages to using an historical approach. Limitations include not fully reflecting the recent increases in women's labor force participation, real increases in Social Security benefits, or increases in the number of beneficiaries retiring earlier—suggesting that estimates for 1993 may be somewhat larger than for future years. Advantages include being able to know definitively at what age people in the sample claimed benefits and to determine how their Social Security income would have been different if benefits had been claimed earlier. Another advantage of using an historical approach is that it measures effects on people of all ages within the Social Security population. This is important because, as beneficiaries age, they exhaust other income sources, and the importance of Social Security to total income rises (See chart 1 for cross-sectional data on the importance of Social Security by age).

Chart 1  
**Social Security Benefits as a % of Total Income Rises with Age, Across Income Groups**



Source: Social Security Administration, Office of Retirement Policy tabulations of the March 1998 Current Population Survey. Data are for 1997.

\*Income groups rounded to the next highest thousands.

### **Only Accounts for Changes in Social Security Income**

This approach does not measure changes in income (other than Social Security) that could have occurred if the RET at 62 or the RET at NRA had never existed. For example, it is plausible that people would choose to work and earn more in the absence of an earnings test. However, economic research has found that the RET has only modest effects on aggregate labor supply. This could be because workers take account of a number of factors when making work and retirement decisions (the availability and size of private pensions, health status, job characteristics, personal preferences, etc.).

### **Assumes Benefits Received Early Will Not be Saved**

The elimination of RET at 62 is likely to cause people to file for permanently reduced benefits. However, it is not known what such people would do with these reduced benefits. They may save or invest a portion of them and have higher asset income later in life. While this analysis does not take such effects into account, economic research suggests that individuals at or near the poverty level are not likely to save this additional income.

## POVERTY ESTIMATES FOR ELIMINATING THE RETIREMENT EARNINGS TEST

Eliminating the RET is likely to encourage some beneficiaries to apply earlier for benefits and, as a result, receive a lower monthly benefit in the long run. Depending on the amount of a beneficiary's income from other sources, this reduction in monthly benefits may reduce his or her total income below the poverty threshold (\$7,990 a year for an aged individual and \$10,070 for an aged couple in 1999).

If the RET were eliminated at the NRA (currently age 65), the increase in the incidence of poverty would be small for several reasons: Few people currently delay receipt of Social Security benefits beyond age 65; those who do typically have incomes well above the poverty level; and accelerating the receipt of a worker's benefit to age 65 would generally not lower benefits enough to cause the beneficiary (or the beneficiary's survivor) to become poor. Eliminating the RET at age 62, however, would cause the income of some beneficiaries to fall below the poverty level.

### Retirement Earnings Test at the Normal Retirement Age

Elimination of the RET at NRA may encourage some who now plan to retire later than the NRA to file for benefits at the NRA, but the poverty effects stemming from elimination of the RET at NRA are estimated to be minimal. The most important reason for this is that benefits to a surviving spouse (widow or widower) would not generally be reduced below the deceased worker's full benefit as a result of eliminating the RET at the NRA.

In 1998, 9 percent of insured workers started receiving retired worker benefits at age 65 and 1 month or later. It is unclear to what extent insured workers would change their filing behavior, so poverty estimates are provided based on four separate filing scenarios (See table 1).

Table 1  
**Filing Scenarios for Repeal of the Retirement Earnings Test at the  
Normal Retirement Age through Age 69**

<b>Filing Scenarios</b>	<b>Assumed Percentage of People Currently Filing for Benefits after Age 65 Opting to File by Age 65 and 0 Months</b>
Scenario A	0%
Scenario B	20%
Scenario C	50%
Scenario D	100%

There would be a negligible effect on poverty under Scenario A, and only about 2,000 people aged 62 and older would be moved into poverty under Scenario D in 1993 (See table 2).

Table 2  
**Poverty Estimates Based on Different Filing Scenarios for Eliminating the Retirement Earnings Test at Normal Retirement Age**

Number of People Age 62+ Moved into Poverty	Aged 62+ Poverty Rate Before and After Change
	<u>Before</u> 12.0%
<u>Alternative Scenario</u>	<u>Alternative Scenarios</u>
A Negligible effect	A 12.0%
B 500	B 12.0%
C 1,000	C 12.0%
D 2,000	D 12.0%

Source: Social Security Administration, Office of Policy, February 2000.

### **Eliminating the Retirement Earnings Test at 62**

Eliminating the RET at ages 62 through 69 could raise the number of beneficiaries in poverty. Much of this effect would be due to more workers filing for benefits earlier and receiving benefits permanently reduced below the full-benefit level. Evidence suggests that the effects of increased work efforts would be unlikely to offset these reductions.

Filing for benefits before the NRA is advantageous in the short run for workers, but it can be disadvantageous later on—particularly for their surviving spouses. The lower benefit for a worker filing at age 62 in 2000 rather than waiting until his or her NRA (reduced 20.8 percent in 2000 and 30 percent when the NRA increases to 67 in 2022) is intended to be actuarially fair so that beneficiaries, on average, will receive the same total lifetime benefits as they would have received if they filed for benefits at the NRA. In the future, however, much of this reduction below the full-benefit level would pass through to surviving spouses and could make their benefits inadequate.

In 1998, 48 percent of insured workers opted for benefits at either 62 and 0 months or 62 and 1 month, and 79 percent of insured workers opted for benefits before age 65. It is unclear how the 52 percent of individuals who currently file for benefits after age 62 and 1 month would change their filing behavior, so estimates are provided under four scenarios. (See table 1 for scenarios. These scenarios are based on the percentage of people who currently file for benefits after age 62 and 1 month who are assumed to file by age 62 and 1 month).

Based on these assumptions about how filing behavior would be affected, eliminating the RET at age 62 could have moved up to about 700,000 people aged 62 and older into poverty and increased their poverty rate from 12.0 percent up to 13.9 percent in 1993 (See table 3).

Table 3  
**Poverty Estimates Based on Different Filing Scenarios for Eliminating the Retirement Earnings Test at Age 62**

Number of People Age 62+ Moved into Poverty	Aged 62+ Poverty Rate Before and After Change
	<u>Before</u> 12.0%
<u>Alternative Scenario</u>	<u>Alternative Scenarios</u>
A Negligible effect	A 12.0%
B 140,400	B 12.4 %
C 351,100	C 12.9 %
D 702,200	D 13.9%

Source: Social Security Administration, Office of Policy, February 2000.

## DEMOGRAPHIC PROFILES OF POVERTY EFFECTS OF ELIMINATING RET AT 62

Detailed demographic breakouts of who could have been affected in 1993 by eliminating the RET at 62 are summarized below.

**Gender**—Up to 500,000 women could be moved into poverty, accounting for 71 percent of the total moved into poverty. Their poverty rate could increase from 14.8 percent up to 17.1 percent (See table 4).

**Marital Status**—Widow(er)s could account for 55 percent of the total moved into poverty (up to 387,000). The poverty rate for widow(er)s is 19.6 percent; it could increase to 23.2 percent. Married couples could account for 34 percent of the total moved into poverty (235,000), and their poverty rate could increase from 5.8 percent up to 6.9 percent (See table 4).

**Benefit Type**—Beneficiaries receiving worker-only benefits could account for 55 percent of the total moved into poverty. Up to 238,000 surviving-spouse beneficiaries could be moved into poverty (34 percent of the total), and their poverty rate could rise from 19.2 percent up to 22.9 percent (See table 4).

**Age**—Fifty percent of the total moved into poverty could be aged 70-79. The poverty rate for this group could rise from 11.4 percent up to 13.8 percent. Beneficiaries aged 80-89 could account for 36 percent of the total moved into poverty. Their poverty rate could increase from 17.5 percent up to 21.9 percent (See table 4).



Table 4  
**Estimated Poverty Effects of Eliminating the Retirement Earnings Test at Age 62 and Above,  
by Selected Demographic Characteristics**

Demographic Characteristics	Number Moved into Poverty				Poverty Rate Before	Poverty Rate After			
	Percentage of People Currently Filing for Benefits after Age 62 Opting to File at Age 62 (Alternative Scenarios)					Percentage of People Currently Filing for Benefits after Age 62 Opting to File at Age 62 (Alternative Scenarios)			
	A	B	C	D		A	B	C	D
	0%	20%	50%	100%		0%	20%	50%	100%
Total	<sup>1</sup>	140,400	351,100	702,200	12.0%	12.0%	12.4%	12.9%	13.9%
Gender									
Men	<sup>1</sup>	40,400	100,900	201,800	8.2%	8.2%	8.5%	8.8%	9.5%
Women	<sup>1</sup>	100,100	250,200	500,400	14.8%	14.8%	15.2%	16.0%	17.1%
Marital Status <sup>2</sup>									
Married	<sup>1</sup>	47,000	117,600	235,200	5.8%	5.8%	6.1%	6.4%	6.9%
Widowed	<sup>1</sup>	77,300	193,300	386,700	19.6%	19.6%	20.3%	21.4%	23.2%
Divorced/Separated	<sup>1</sup>	10,200	25,500	51,000	23.7%	23.7%	24.1%	24.7%	25.6%
Never Married	<sup>1</sup>	5,900	14,600	29,300	22.5%	22.5%	22.8%	23.4%	24.3%
Benefit Type <sup>3</sup>									
Worker-Only	<sup>1</sup>	76,600	191,400	382,900	9.1%	9.1%	9.4%	10.0%	11.0%
Spouse	<sup>1</sup>	13,100	32,800	65,500	8.1%	8.1%	8.3%	8.7%	9.4%
Surviving Spouse	<sup>1</sup>	47,600	119,000	237,900	19.2%	19.2%	20.0%	21.1%	22.9%
Age									
62-69	<sup>1</sup>	12,300	30,900	61,700	10.0%	10.0%	10.1%	10.2%	10.4%
70-79	<sup>1</sup>	69,700	174,200	348,400	11.4%	11.4%	11.9%	12.6%	13.8%
80-89	<sup>1</sup>	50,900	127,300	254,600	17.5%	17.5%	18.3%	19.7%	21.9%
90+	<sup>1</sup>	7,500	18,700	37,500	19.1%	19.1%	19.9%	21.0%	22.8%

Source: Social Security Administration, Office of Policy, February 2000.

Notes:

<sup>1</sup>The effect would be negligible.

<sup>2</sup>Respondents to the Current Population Survey indicated their marital status at the time of the survey. These individuals may or may not be receiving a benefit based on their marital status.

<sup>3</sup>Some people affected by this proposal are not beneficiaries (they share a household with a beneficiary), so rows do not add up to the total number of people affected. The "Spouse" category includes divorced spouse beneficiaries and dually-entitled spouse beneficiaries, and the "Surviving Spouse" category includes surviving divorced spouse beneficiaries and dually-entitled surviving spouse beneficiaries.